Moody's Investors Service

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New Issue: Honolulu (City & County of) HI

MOODY'S ASSIGNS Aa2 RATING TO HONOLULU, HAWAII'S GENERAL OBLIGATION BONDS

Aa2 Rating and Stable Outlook Affirmed on Approximately $1.9 Billion of Outstanding Debt, Including Current Offering

Municipality
HI

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series 2005A, Series 2005B and Series 2005C	Aa2

Sale Amount	$329,780,000
Expected Sale Date	05/19/05
Rating Description	General Obligation Bonds

Opinion

NEW YORK, May 17, 2005 -- Moody's Investors Service has assigned a Aa2 rating and stable outlook to the City and County of Honolulu's General Obligation Bonds, Series 2005A, Series 2005B and Series 2005C to be issued in the approximate amount of $329.8 million. The bonds will refund approximately $139.8 million of the city's outstanding general obligation bonds for debt service savings and will provide long term financing for approximately $200 million of projects initially financed through the city's commercial paper program. In conjunction with the current credit review, Moody's has also affirmed the Aa2 rating and stable outlook on the city's approximately $1.5 billion of outstanding general obligation bonds. The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund. The Aa2 rating primarily reflects the city's solid economic performance, rising real estate values on Oahu which have spurred steady growth in assessed valuation, the city's stable financial performance which reflects management's ability to control spending and raise property tax rates when needed, and a manageable debt profile.

ROBUST ECONOMY BENEFITS FROM STRONG PERFORMANCE OF TOURISM SECTOR

Honolulu's economy has performed remarkably well in recent years, particularly given the sharp declines in travel to Hawaii following the 9/11 terrorist attacks. Unemployment in Honolulu was the lowest in the nation at 2.8% in March 2005, a rate which equalled that of the State of Hawaii (rated Aa2/stable) and compared favorably to a 5.2% rate for the nation in the same month. Rising real estate values have had an important influence on the local economy, but a variety of other factors have contributed as well. Visitor traffic has improved significantly since the steep declines suffered immediately following the 9/11 terrorist attacks. Eastbound (primarily Asian) and other international traffic still lags historical performance, but Westbound traffic (primarily from the U.S. West and East coast markets) has more than offset these losses. Hawaii remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Examples include sports- and eco-tourism as well as a growing inter-island cruise business, all of which attract a higher percentage of first time visitors and stimulate longer average stays. Moody's notes that airline capacity serving the Hawaii tourism market relies on the health of the financially volatile airline industry. Moody's also notes improving diversity in the Honolulu economy which includes the military, health care, and banking sectors as important contributors. The city's successful efforts to finance light rail development through a recently-authorized general excise tax should help stimulate further housing and business development in west Oahu, especially in the Kapolei and Ko Olina areas. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are also favorable with per capita and median family income at 101.9% and 120.1% of the U.S., respectively.

STRONG OAHU REAL ESTATE MARKET SUPPORTS CONTINUING TREND OF ASSESSED

VALUATION GROWTH

An important element of Honolulu's economic stability has been the robust Oahu real estate market, which has led to accelerating growth in assessed values since 2001. Following a period of rapid escalation in property values in the late 1980s and early 1990s Honolulu's tax base experienced significant erosion from 1996 through 2001, losing almost one-fifth of its value during that period. However, since 2000, assessed valuation has grown by an average of 5.2% annually, achieving a substantial $92.4 billion in 2005. Residential, commercial and industrial real estate have all contributed to the growth, which should continue to translate into rising taxable values over the near term given the lag between real estate prices and assessed valuation. Moody's also notes that the current real estate market shows no signs of the type of speculative bubble which occurred in the early 1990s. Honolulu's 2005 assessed value per capita totals an impressive $102,383 and points to an unusually wealthy tax base.

SOUND FINANCIAL PERFORMANCE

The city's financial performance has been stable in recent years, due in large part to management's willingness to raise property tax rates as needed, combined with the city's successful multi-year effort to control expenditures. Recent growth in assessed valuation is particularly significant to the city's credit profile in that property tax revenues represent approximately two-thirds of operating revenues. Just as important, however, is the city's willingness to raise tax rates to fund increasing fixed costs such as pension, health and debt service expenditures. In addition, a variety of cost-cutting measures such as workforce reductions, department consolidations, hiring freezes and increasing self-support for enterprise activities, have resulted in relatively flat expenditure growth over time. As a result, management's commitment to maintaining budget balance and improving reserves has been increasingly evident and continues to be an important factor in Moody's credit evaluation of Honolulu.

Audited financial results for fiscal 2004 indicate a $10.5 million operating deficit in the General Fund which resulted in total fund balance of $62.3 million, or 8.7% of General Fund revenues; unreserved fund balance totaled $41.5 million, or 5.8% of revenues, which is only slightly above the city's target of a minimum 5% unreserved General Fund balance. Much of the 2004 deficit is attributable to one-time capital projects. Leading up to fiscal 2004, however, the city experienced substantial operating surpluses in both fiscal years 2002 and 2003 following an understandably difficult 2001 which included 9/11-related declines in transient accommodations tax receipts as well as higher spending requirements, especially for public safety. Nevertheless, the city has posted significant operating surpluses in four of the six audited years since 1999 and an additional surplus is projected to add roughly $6 million to unreserved General Fund balance in fiscal 2005. The city also maintains a $5 million rainy day fund outside the General Fund, providing additional flexibility.

Going forward, Moody's believes that the city's financial position should remain stable as it benefits from a combination of growing tax revenues and the ongoing savings associated with structural spending reforms implemented in recent years. Nevertheless, it remains likely that Honolulu will continue to face its share of budget challenges in the near term, in part due to the rising pension and health costs mentioned above. Despite these ongoing budget issues, Moody's believes that the city's demonstrated ability to manage its finances well under difficult circumstances bodes well for future financial stability, especially in light of anticipated revenue growth.

MANAGEABLE DEBT POSITION MODERATED BY REASONABLE BORROWING PROGRAM AND GROWING TAX BASE

Moody's expects that Honolulu's debt levels will continue to remain manageable given reasonable borrowing assumptions and the expectation of continued tax base growth in the near term. In addition, Honolulu benefits from the active role the state government plays in financing traditional municipal capital needs more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education.

Management has begun to fund the construction activities of various enterprise systems from system rates rather than property taxes. As a result, future borrowings will emphasize revenue bond offerings rather than general obligation issuances. Debt burden measures compare favorably to other cities and counties in the U. S. with overall debt representing only 1.7% of fiscal 2005 taxable values. Including the current offering, the city has approximately $1.9 billion of outstanding general obligation bonds and about $463.9 million of remaining unissued authorization. Approximately 58.9% of the city's outstanding general obligation debt is retired in ten years.

Outlook

The stable rating outlook for Honolulu reflects Moody's expectation that the city's economy will continue to perform well and that assessed valuation will grow further in the near-term. The stable credit outlook also incorporates Moody's expectation that city management will continue to take the actions necessary to ensure fiscal stability in light of rising pension and health costs over the near- to medium-term.

KEY STATISTICS

2000 population: 876,156

1999 per capita income: $21,998 (101.9% of U.S.)

1999 median family income: $60,118 (120.1% of U.S.)

2005 full valuation: $92.4 billion

Direct and overall debt burden: 1.7%

Payout of principal, 10 years: 58.9%

FY 2004 total General Fund balance: $62.3 million (8.7% of General Fund revenues)

FY 2004 unreserved General Fund balance: $41.5 million (5.8% of General Fund revenues)

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